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Arthur C. Jones Jr.

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contend, in the face of the *Forbes* and *Rickman* cases, that he could not "reopen" the value so as to offer his evidence that the pearls were of lesser value. 

**Milton Short.**

**Taxation—Powers of Appointment—Will Contests—Taxation of Property Passing under Compromise of Attempted Testamentary Exercise of Power of Appointment**

Decedent, Zachary Smith Reynolds, died at the age of twenty, being at that time the beneficiary of three trusts set up by the deed and wills of his parents. One trust directed that he receive the income until he reached 28 years of age, at which time he became outright owner; from the other trusts he was to receive income for life. All three trusts gave him a general testamentary power of appointment over the trust property whereby he could, in his sole discretion, appoint to anyone. In default of exercise of the power, the property was to go to his descendants, or if he had none, to his brother and sisters and their issue *per stirpes*. Decedent's attempt to exercise the power in favor of his brother and sisters by a New York will was contested by his two children who (1) denied the validity of the New York will and, (2) challenging the right of the brother and sisters to take in default, asserted their own right to do so. The brother and sisters claimed under decedent's will and in the alternative as takers in default, contending that one child was precluded because of a prior separation agreement and the other by reason of illegitimacy. These issues were never finally resolved by judicial decision, and eventually a compromise was entered into under which 37 1/2% of the trust property went to the brother and sisters. In a 5 to 4 decision* the Supreme Court de-

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*Helvering v. Safe Deposit and Trust Company of Baltimore, — U. S. —, 62 S. Ct. 925, 86 L. ed. (Adv. Ops.) 851 (1942). Both the majority and minority agreed that if the power of appointment were unexercised decedent did not have such an interest in the trust property as to require its inclusion in his gross estate under §302(a). This conclusion was based upon the legislative history of the statute and upon implications from *United States v. Field*, 255 U. S. 257, 41 S. Ct. 256, 65 L. ed. 617 (1921), rather than upon the economic equivalence of decedent's rights to complete ownership. Thus the court refused to expand the scope of §302(a) by the concept of "substantial ownership" which is developing under §22(a) for income tax purposes. 1 Paul, *Federal Estate and Gift Taxation* (1942) §4.12, p. 223. Except for the unavailability of the corpus, the ordinary life estate coupled with a general power of appointment closely resembles a fee simple. For this reason, the inclusion of such property under §302(a), even though the power be unexercised, would perhaps have been not unreasonable, especially inasmuch as by so doing the court, at one stroke, could have escaped the complicated question of apportionment raised by their actual decision, and also laid at rest any possible doubt concerning the constitutionality of the taxation under the 1942 Revenue Act of property subject to an unexercised power of appointment. See Reeves v. Fidelity & Columbia Trust Company (1941-1943) C. C. H. Inheritance Tax Service—State, ¶90, 530 (Ky. 1942), where the court at the end of its opinion expresses doubts as to the ability of the legislature to tax property subject to an unexercised power as a part of the donee's estate.
cided that such part of this share as the brother and sisters received because of their claim as appointees under decedent's will should be included in decedent's gross estate for the purpose of computing the Federal Estate Tax under §302(f) providing for the inclusion of property passing by the exercise of a general power of appointment.2

Prior to the passage of the 1942 Federal Revenue Act,3 this decision represented perhaps as good a solution as was possible to an extremely complicated and troublesome problem. It had been settled that property subject to an unexercised power of appointment was not includible in decedent's gross estate under §302(f) before the 1942 Amendment.4 Property subject to a general power of appointment was includible under §302(f) if the power was exercised and the property passed pursuant to this exercise.5 Even where a general power was validly exercised appointees under it, who were also takers in default under the will of the donor of the power, could exempt the property from the tax by electing to take in default rather than as appointees, the property being considered as not having passed.6 The question involved in the instant case is how much, if any, of property subject to a general power of appointment is to be considered as coming within the scope of §302(f) so as to be includible in decedent's estate for the purpose of the levy of the Federal Estate Tax, where an attempt has been made to exercise the power, and the validity of this attempt has never reached judicial decision but a compromise agreement gives the attempted appointees some part at least of what they would have taken as such.

Three possibilities are conceivable here: (1) to include none of the property; (2) to include only part of the property; or (3) to include all of the property. The four dissenting judges in the instant case took

2* Revenue Act of 1926, c. 27, 44 Stat. 9; 26 U. S. C. A. §811 (1940): "§302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—(f) (as amended by §803, Revenue Act of 1932, c. 209, 47 Stat. 169) To the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of or intended to take effect in possession or enjoyment at or after death, or (3) by deed under which he has retained for his life or any period not ascertainable without reference to his death or for any period which does not in fact end before his death (A) the possession or enjoyment of, or the right to the income from, the property, or (B) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth."

the position that none of the property should be included, on the assumption that the attempted exercise of the power was invalid;\(^7\) hence anything which the brother and sisters took came to them because of their claim as takers in default and was thus outside the scope of §302(f). These judges regarded Helvering \textit{v. Grinnell}\(^8\) as supporting this point of view, and indicated that the doctrine of \textit{Lyeth v. Hoey}\(^9\) had no application since in the instant case a state court had said that no property had passed by the exercise of the power. Furthermore, they felt that the task of calculating the relative weight of the conflicting claims so as to determine what part of the brother's and sisters' share came to them through the bargaining force of the attempted exercise of the power and what part did not was virtually impossible.

The majority decided that some part of the share going to the brother and sisters under the compromise was attributable to the attempted exercise of the power in decedent's will and should therefore be included in decedent's gross estate under §302(f). This result was reached by applying the reasoning of \textit{Lyeth v. Hoey}\(^10\) in which property received by an heir under a compromise settlement of his contest of his ancestor's will was held to be property taken "by inheritance" and hence not taxable as income, the rationale being that the taxation of property distributed in compliance with the terms of a compromise depends upon the factors which influenced the compromise. The court indicated that the invalidity of the attempted exercise of the power had never been carried to final judicial decision and that it was a substantial factor in the compromise which was eventually reached,\(^11\) while the alternative claim of the brother and sisters as takers in default was extremely tenuous. Although this conclusion seems reasonable, it injects into every case of this character the tremendously complicated issue of the relative effect of conflicting claims upon a compromise. The majority felt, however, that the difficulty of evaluation should not prevent taxation in accordance with the realities of the compromise.\(^12\)

Although rejected by both the majority and minority of the court, the conclusion of the Tax Commissioner that all of the property should be included seems about as sensible as saying that none of it should be. Assuming that the validity of neither claim has reached judicial decision, the argument is that the brother's and sisters' alternative claim as takers in default was so tenuous as to have played no part in determining their

share under the compromise, and that such share was entirely due to their claim as appointees under decedent's will.

The 1942 Federal Revenue Act\textsuperscript{13} amends §302(f) by providing for the inclusion in decedent's gross estate of any property with respect to which decedent has at the time of his death a general power of appointment. Thus the tax is made to fall in accordance with the shifting of economic benefit rather than according to strict property rules under which it is determined whether any property passed through the exercise of a general power. One effect of this amendment is the future elimination under the Federal Estate Tax of the type of problem in the instant case where a will purporting to exercise a power of appointment has been compromised. Since the requisite for inclusion under §302(f) is now the mere existence of the power in decedent at the time of his death, all the property subject to the power would be included. The question whether any part of a compromise share is attributable to the attempted exercise of a general power of appointment and the necessity for the calculation of the relative weight of conflicting claims are no longer present.

An analogous problem exists under state law. A provision expressly imposing the Inheritance Tax upon property in accordance with compromises reached in will contests\textsuperscript{14} was eliminated from the Revenue Act of North Carolina in 1941.\textsuperscript{15} Evidently this change was prompted by fear of the difficulties inherent in the situation of the principal case, and a desire to have the tax levied in accordance with the state of the probate records,\textsuperscript{16} a result which has been reached under similar statutes in a majority of states passing on the question.\textsuperscript{17}

The particular problem of the taxability of property subject to a power of appointment where an attempt to exercise the power by will

\textsuperscript{13} Federal Revenue Act of 1942, tit. IV, Part I, §403 a-f (1-2): "§403. Powers of Appointment. (a) General rule—§811 (f) is amended to read as follows: (f) Powers of Appointment—(1) In general—To the extent of any property (A) with respect to which the decedent has at the time of his death a power of appointment. . . ." This statute also provides for the taxation of property subject to special powers of appointment.

\textsuperscript{14} N. C. PUB. L. 1937, c. 127, §1 First, N. C. CODE ANN. (Michie, 1939) §7880(1), First. "§1: A tax shall be and is hereby imposed upon the transfer of any property, real or personal, or of any interest therein or income therefrom, in trust or otherwise, to persons or corporations, in the following cases: First. When the transfer is by will or by the intestate laws of this state from any person dying seized or possessed of the property while a resident of the state; or when the transfer is by settlement, contract or agreement, or by any court order or otherwise, to any person or persons, by reason of claim or claims arising by virtue of intestate laws, in controversies or contests as to the probate or construction of any will or wills, or any trust or other instrument executed or created by any person dying seized of the property while a resident of this state."


\textsuperscript{16} 19 N. C. L. Rev. at p. 526 (1941).

\textsuperscript{17} See Note (1932) 78 A. L. R. 716.
has resulted in compromise, is not affected by this change since the North Carolina Inheritance Tax Law contains a provision\textsuperscript{18} similar to the 1942 Federal Law whereby property subject to an unexercised power of appointment is taxed as though the power had been exercised. Hence whether property is to be taxed according to the terms of the compromise or the state of the probate records, any part of it which was subject to a power of appointment, exercised or not, would be taxed.

Nevertheless, since the North Carolina law imposes an inheritance tax upon property subject to a power of appointment at a rate determined by the relationship of the recipient of the property to the donor of the power,\textsuperscript{19} greater opportunities for obtaining lower rates are open to the well-advised individual or institution under the present rule of taxing according to the state of the probate records than under the rule that the inheritance tax is to be levied in accordance with compromises in will contests. For example, property passing to strangers is taxed at a higher rate than property passing to relatives.\textsuperscript{20} A power of appointment is exercised by will in favor of a stranger to the donor of the power. A son of the donor who is a taker in default contests the will. The parties can then agree that the will shall not be probated with the result that the property goes by default to the son who then pays an agreed share to the proponent of the will. Under the rule of taxation according to the state of the probate records, all of the property will then be taxed at the rate imposed upon sons of donors, in spite of the fact that part of it actually went to a stranger who is taxed at a higher rate. However, under the rule of taxation according to the compromise, the property going to each party would be taxed at the correct rate.\textsuperscript{21}

\textsuperscript{18} N. C. \textsc{Code Ann.} (Michie, 1939) \textsection7880(1), Fifth. “Whenever any person or corporation shall exercise a power of appointment derived from any disposition of property made either before or after the passage of this law, such appointment when made shall be deemed a transfer taxable under the provisions of this law in the same manner as though the property to which such appointment relates belonged absolutely to the donee of such power and had been bequeathed or devised by such donee by will, and the rate shall be determined by the relationship between the beneficiary under the power and the donor; and whenever any person or corporation possessing such power of appointment so derived shall omit or fail to exercise the same within the time provided therefor, in whole or in part, a transfer taxable under the provisions of this law shall be deemed to take place to the extent of such omission or failure in the same manner as though the persons or corporations thereby becoming entitled to the possession or enjoyment of the property to which such power related had succeeded thereto by a will of the donee of the power failing to exercise such power, taking effect at the time of such omission or failure.”

\textsuperscript{19} See note 18 supra.

\textsuperscript{20} N. C. \textsc{Code Ann.} (Michie, 1939) \textsection7880(3-5).

\textsuperscript{21} See Taylor v. State, 40 Ga. App. 295, 149 S. E. 321 (1929); Note (1929) \textsc{Col. L. Rev.} 1164. However, the usual result under this rule would be to keep the property in lower brackets because the tax would then be levied after the property had been split up according to the compromise.
An examination of the Estate and Inheritance Tax Laws of other states indicates a considerable variety of provisions for the taxation of property subject to powers of appointment. These statutes fall into three principal categories: (1) those which, like North Carolina, impose a tax upon property subject to a power of appointment not only where the power is exercised but also where there has been an omission or failure to exercise it, (2) those which tax only property which is transferred through the exercise of a power, and (3) those in which no specific reference is made to powers of appointment.

Twenty states impose a tax upon both the exercise and non-exercise of a power of appointment. Nineteen of these states have an identical statute. North Carolina and Florida, however, further provide that the rate of taxation shall be determined by the relationship of the beneficiary under the power to the donor, and the Kentucky statute contains a proviso that the transfer shall be deemed to take place at the time of the death of the donor and that the assessment shall be made at that time.

Rhode Island specifically taxes property subject to either a "general or limited" power. North Dakota, in somewhat different language, taxes transfers of property subject to both exercised and unexercised powers, but as of the estate of the donor, not the donee, of the power.

The statutes of thirteen states tax only property which is transferred through the exercise of a power of appointment, and no tax is specifically imposed in the event of non-exercise. The statutes of Del.


23 See note 18 supra.


aware, Illinois, New York, and Washington are couched in identical language; New York and Washington, however, providing further that, if at the time an appointment takes effect the donor of the power was a resident and the donee was a non-resident, the appointed property shall be taxable as having been transferred in the estate of the donor. Pennsylvania and Tennessee tax all property passing by the exercise of powers of appointment as of the estate of the donor of the power rather than that of the donee. The language of the Arizona and Mississippi statutes is identical with that of the Federal law\textsuperscript{26} under which the principal case was decided. California regards the gift of a power of appointment as a taxable transfer from donor to donee at the date of donor's death, and provides that where the donor died before the taking effect of the statute that the subsequent exercise of the power shall be a taxable transfer.

The Inheritance, Estate, Transfer, or Succession Tax Laws of fifteen states\textsuperscript{27} do not specifically mention the taxation of property subject to powers of appointment. Connecticut, Maryland, Oklahoma, and Virginia refer, however, to certain powers reserved in one who disposes of his property. Nevada\textsuperscript{28} has no Inheritance, Estate, Transfer, or Succession Tax.

\textbf{Arthur C. Jones, Jr.}

\textsuperscript{26} See note 2 \textit{supra}.


\textsuperscript{28} Nev. Comp. Laws (Hillyer, 1929).